Standing Committee on Finance / Select Committee on Finance
Parliament of the Republic of South Africa
Plein Street
Cape Town
South Africa

By email: awicomb@parliament.gov.za
tsepanya@parliament.gov.za
nmangweni@parliament.gov.za

2 March 2020

Chair, Members,

Budget 2020 Fiscal Framework and Revenue Proposals – Preliminary Comment

1. We present herewith our commentary on the fiscal framework and revenue proposals included in the 2020 Budget Review.

A. Fiscal framework

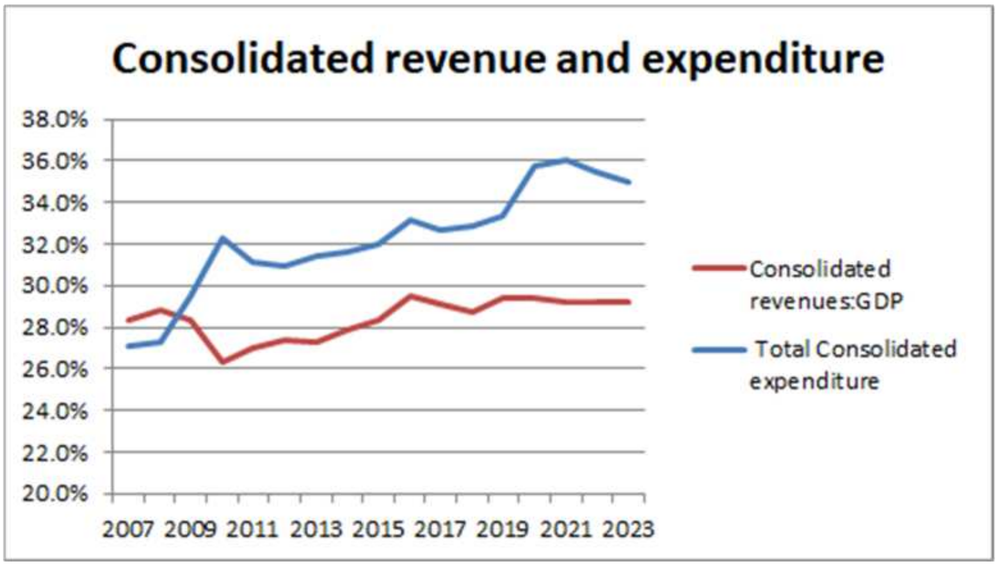
2. For a number of years, South Africa has faced an extremely challenging economic environment. This environment has been characterised by weak economic growth, high unemployment and inequality, high revenue shortfalls, growing debt levels, and spending pressures (particularly from state-owned entities, most notably Eskom).

3. From a fiscal perspective, this challenging environment has translated into a stubbornly high fiscal deficit every year since 2009/10, and the 2019/20 fiscal year will be no different in this regard. The budget deficit, estimated at 6.3% of GDP for 2019/20, is estimated to grow to 6.8% of GDP in 2020/21, and then to only fall to 6.2% and 5.7% of GDP in 2021/22 and 2022/23 respectively. This is of significant concern, especially in light of the 2019 Budget estimate of a deficit of 4.5% of GDP for 2019/20.

4. Since 2008/09, total government expenditure has grown from 29.5% of gross domestic product (GDP) to an expected 35.7% in the current fiscal year. In the same period, however, gross consolidated tax revenues have only grown from 27.1% of GDP to 28% of GDP. It is abundantly clear, therefore, that growth in government expenditure has far outpaced growth in revenues, despite substantial tax increases in the last five years.

5. The disparity between revenue and expenditure is clearly illustrated in the below graph. It is clear that there has been a structural increase in expenditure (and an increasing trend) since 2008/9, leading to a structural fiscal deficit.

PricewaterhouseCoopers Tax Services (Pty) Ltd.
4 Lisbon Lane, Waterfall City, Jukskei View, 2090, Private Bag X36, Sunninghill, 2157
T: +27 (0) 11 797 4000, F: +27 (0) 11 209 5800, www.pwc.co.za



Revenue and the fiscal deficit

6. Regarding revenue, substantial tax increases over the past few years have, unfortunately, not had the desired result of narrowing the fiscal deficit, and differences between projected and collected revenues have widened, particularly over the last four years .

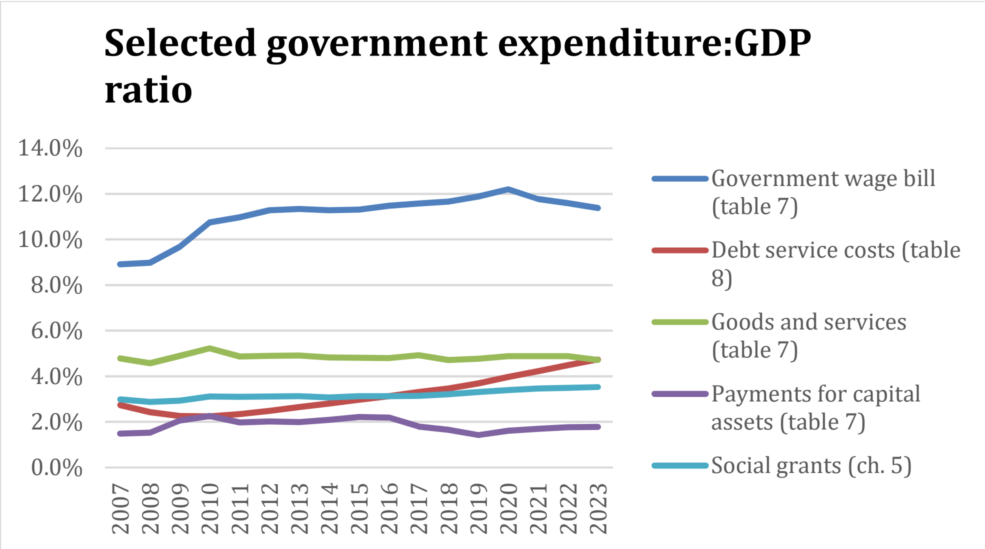
7. As acknowledged in this year's Budget, this is largely due to a persistent slowdown in economic growth and a weakened SARS. The Budget further states (quite correctly in our view) that new tax increases at this point could further hamper South Africa's economic recovery and growth, the inevitable result of which would be additional downward pressure on revenues.

Expenditure and the fiscal deficit

8. As regards the expenditure component of the fiscal deficit, the two primary drivers of the rapid increase in expenditure since 2009 have been the public sector wage bill and debt service costs. In 2007/08, the public sector wage bill, at 9% of GDP, comprised 36.2% of government expenditure, excluding debt service costs. For the current fiscal year, it is expected that the public sector wage bill will have increased to 12.2% of GDP, comprising 40% of government expenditure, excluding debt service costs and support for state-owned entities. The public sector wage bill has grown by approximately 40% in real terms over the past 12 years, and it is widely accepted that remuneration growth is increasingly out of line with the rest of the economy.

9. A similar position arises with respect to debt service costs. In 2008/09, debt service costs, at 2.3% of GDP, comprised 7.7% of government expenditure. For the current fiscal year, it is expected that debt service costs will be at 4% of GDP and will comprise 11% of total government expenditure.

10. Other key components of government expenditure (i.e. expenditure on goods and services, payments for capital assets and social grants) have largely remained relatively stable in comparison with expenditure on the public sector wage bill and debt service costs, as illustrated in the graph below.



11. It is readily apparent that the structural increase in spending has largely been driven by the wage bill, with debt service costs being a function of the increasing debt levels due to the large fiscal deficits over the space of the last decade or so.

12. This expenditure profile of government is extremely concerning. Debt service costs and expenditure on the public sector wage bill are, by their nature, consumption expenditure. Although expenditure on the public sector wage bill can and does have a short-term positive effect on economic growth, this effect is, arguably, short-lived relative to the positive long-term effects of less consumption spending and greater expenditure on infrastructure.

13. It has been argued by many commentators that a reduction in the public sector wage bill could have an adverse effect on government service delivery. However, this argument ignores the fact that increasing expenditure on the public sector wage bill (together with increasing debt service costs) has been crowding out expenditure by government on goods and services, thereby already adversely affecting service delivery. It also ignores the fact that the increase in the wage bill has primarily been driven by real increases in remuneration and not by increases in headcount. This would itself, have a detrimental effect on service delivery by crowding out needed growth in headcount.

14. Following the tabling of the Budget Review, some commentators have argued that, at approximately 35% of total government expenditure, expenditure on the public sector wage bill is "in line with global standards". We are not aware of any research or data in support of this broad statement, nor is it clear what global standards are being referred

to. Although there appears to be no consistent, reliable and readily available data on this issue, we have conducted some preliminary high-level research in this regard. This research tends to indicate that expenditure in South Africa on the public sector wage bill is, in fact, relatively high when compared to other countries. In a recent (January 2019) comprehensive IMF working Paper[1], the authors analysed a sample of 137 countries across a broad spectrum. The following table, which depicts levels of tax revenues, the government wage bill and other government expenditure all as a percentage of GDP, is presented on page 9 of the published study:

	Levels of Revenue, Wage Bill and Other Expenditure											
	Revenue as a percentage of GDP				Wage bill as a percentage of GDP				Other expenditure as a percentage of GDP			
	Min	Med	Ave	Max	Min	Med	Ave	Max	Min	Med	Ave	Max
All Countries	4.9	28	30	72	0.8	8.5	8.4	23	3.9	23	24	63
Resource Rich	4.9	30	32	72	0.8	5.8	7.1	17	3.9	20	21	63
Non-resource rich	8.3	28	30	66	1.6	8.9	8.7	23	5	23	24	47
Low debt	8.4	35	34	66	1.6	9.2	9	23	6.9	26	25	52
High debt	4.9	25	27	72	0.8	7.9	7.9	21	3.9	20	22	63
Advanced	17	42	42	57	3.5	11	11	18	10	34	33	47
Resource Rich	51	55	55	57	12	13	13	14	27	31	31	36
Non-resource rich	17	41	42	57	3.5	11	11	18	10	34	33	47
Low debt	31	42	44	57	6.5	11	11	18	22	34	34	47
High debt	17	41	39	52	3.5	11	9.6	13	10	32	30	43
Non-advanced	4.9	24	26	72	0.8	7.2	7.6	23	3.9	19	20	63
Resource Rich	4.9	28	30	72	0.8	5.6	6.7	17	3.9	19	21	63
Non-resource rich	8.3	24	25	66	1.6	7.5	7.8	23	5	19	20	46
Low debt	8.4	25	27	66	1.6	6.6	7.4	23	6.9	18	20	52
High debt	4.9	24	26	72	0.8	7.4	7.7	21	3.9	19	21	63

15. In the study, the 137 countries were classified according to various criteria, including whether they were “advanced” or “non-advanced”, “resource rich” or “non-resource rich”, and “low debt” or “high debt”. According to these criteria, South Africa was classified as a non-advanced, non-resource rich, low debt country. We have therefore highlighted (in yellow) the categories with countries that are most relevant in the context of a comparison with South Africa.

16. The table shows that, at 12.2% of GDP, South Africa’s public sector wage bill is far higher than:

- the average wage bills of its peers (i.e. non-advanced, non-resource rich and low debt countries, which average between 7.4% and 7.8% of GDP);
- the median wage bills of its peers (which are between 8.4% and 8.5% of GDP); and

[1] Dybczak, K and Garcia-Escribano, M (2019), “Fiscal Implications of Government Wage Bill Spending”, IMF Working Paper WP/19/10, International Monetary Fund.

- both the median (8.5%) and the average (8.4%) of all 137 countries that were subject to the study.

Promoting economic growth in order to reduce the fiscal deficit

17. As already stated above, substantial increases in tax rates over the past few years have not resulted in significantly increased revenues. It has therefore become clear that, in order to increase revenues, higher levels of economic growth are required. Quite simply, it is only when such higher levels of economic growth are realised that revenues will increase.

18. For this reason, the proposal to provide some relief at the level of personal income tax is welcomed. This will undoubtedly support a recovery in economic growth.

19. Insofar as expenditure is concerned, the measures proposed in the Budget to reduce growth in the public-service wage bill are also welcomed.

20. In addition to these measures, we note that the Budget Review recognises that government's contribution to the economy is not matched by adequate spending efficiency. Accordingly, reforms are proposed to improve spending efficiency and reduce waste. The reforms mentioned relate to the improvement of procurement, the strengthening of provincial grants and the reduction of claims against the state (with particular reference to medico-legal claims against the state).

21. The above measures to reduce growth in the public service wage bill and to improve the efficiency of spending and reduce waste will (if realised) all contribute to an improvement in the quality of expenditure of government. As such, these measures will make an important contribution to economic growth and recovery and will thereby – indirectly – have a positive impact on revenue growth.

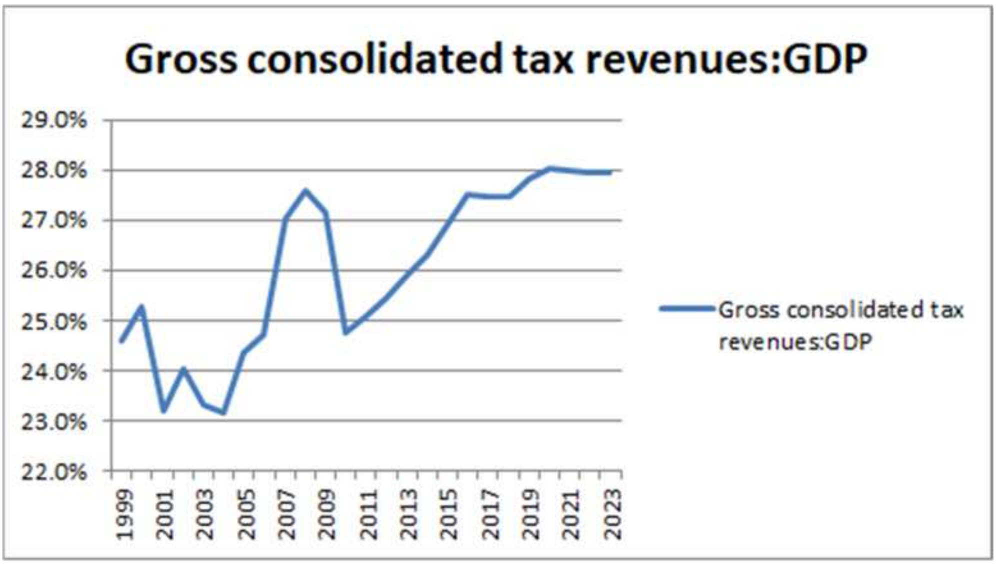
22. We do, however, wish to sound a note of caution. It is absolutely essential that the proposals in the Budget to reduce growth in the public-service wage bill are, in fact, implemented. If the savings in the wage bill are not realised, this will result in the fiscal deficit moving towards 8% of GDP, debt spiralling and make credit ratings downgrades an inevitable.

23. It is concerning that the Budget itself does not provide any detail as to the way in which compensation reductions will affect individual department baselines. It appears that details in this regard will only be finalised in the 2020/21 fiscal year, and there is no mention in the Budget as to when or how details in this regard will be announced.

Level of taxation

24. Despite the relief afforded to individuals by way of the above-inflation adjustments to the personal income tax brackets, it is nevertheless important to bear in mind that the level of taxation in South Africa, relative to GDP, is at record high levels.

25. In 2003/04, gross consolidated tax revenues (before SACU payments) stood at 23.2% of GDP. This ratio reached a peak of 27.6% in 2007/08 before falling substantially in the wake of the global financial crisis. However, tax revenues have since recovered to similar levels and the level of taxation, after being at 27.8% of GDP in 2018/19, is estimated to be 28% of GDP for 2019/20. This ratio is expected to be maintained at 28% for 2020/21 and 2021/22, and to fall marginally to 27.9% of GDP in 2022/23. The below graph illustrates the level of taxation from 1998/99 to 2022/23.



26. As illustrated in the graph, there has clearly been a strong upward trend in the overall tax burden. This year's proposals not to increase any taxes and to provide some relief for individual taxpayers indicates that stabilisation is expected in the medium term. It should, however, be noted that the above is premised on the assumption of real growth in GDP over the next three years.

27. It is acknowledged that South Africa's high income and wealth inequality necessarily requires that its fiscal policy plays a crucial role in reducing inequality. South Africa does extremely well in this regard, with the largest reduction in inequality achieved by any of the countries studied to date by the World Bank (according to the World Bank's South Africa: Economic Update - Fiscal Policy and Redistribution in an Unequal Society, published in November 2014). It must, however, be pointed out that the World Bank has noted that South Africa has probably reached the limit that can be achieved by fiscal policy and that further reductions in inequality require higher and more inclusive economic growth.

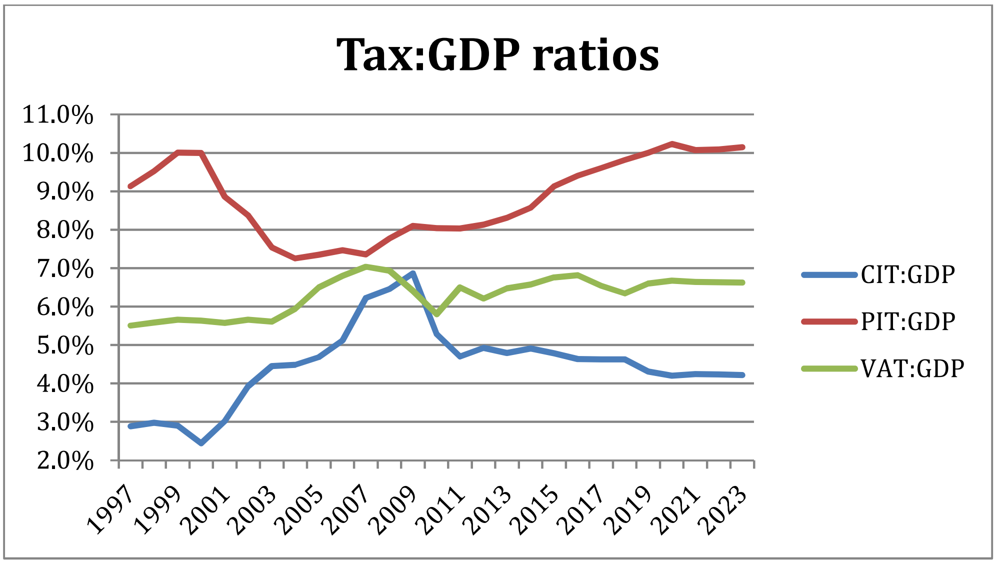
28. That study was based on 2010 data. Since then, South Africa's tax system has been made even more progressive as a result of the tax increases implemented and the

manner in which they have been imposed. The result is that South Africa's tax system and fiscal system as a whole are highly progressive.

Tax mix

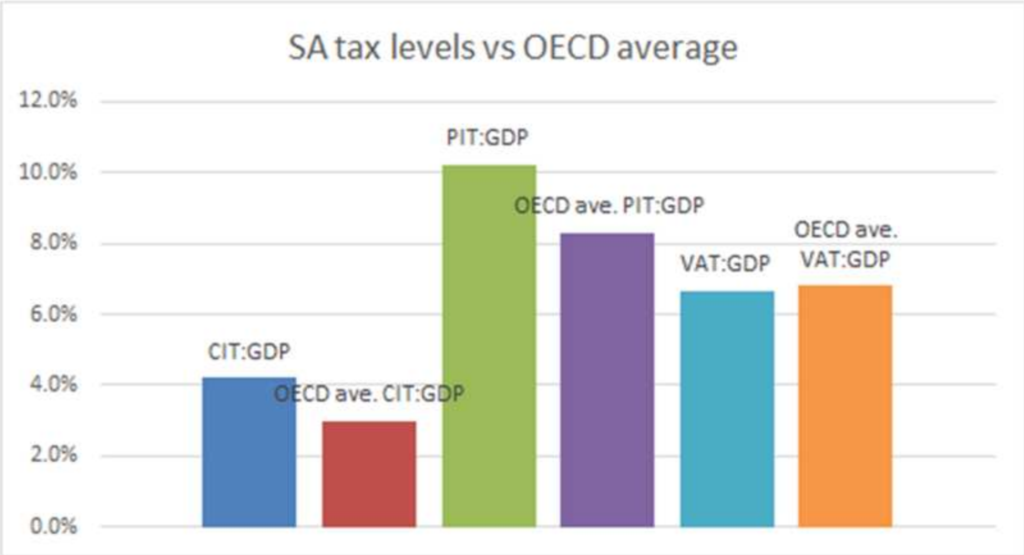
29. In 2020/21, South Africa is forecast to obtain 38.4% (10.1% of GDP) of its tax revenues from personal income tax, 25.3% from VAT (6.6% of GDP) and 16.2% (4.2% of GDP) from corporate income tax in 2020/21.

30. Since the financial crisis of 2008, the individual contributions of each of the three main taxes to the tax mix has changed substantially. As is illustrated in the below graph, the contribution of personal income tax has increased substantially, the contribution of corporate income tax has decreased, while the contribution of VAT has remained relatively constant.



31. The significant drop off in corporate taxes following the financial crisis is evidence of the fact that corporate income tax revenues have come under severe pressure as a result of a poorly performing economy. This clearly supports the widely accepted principle that corporate income tax revenues are particularly susceptible to weak economic growth. Regarding the upward trend in personal income tax, this is a clear result of the substantial tax increases over the past few years, which has, itself, contributed to poor economic growth (and therefore, indirectly, depressed corporate tax revenues).

32. As is shown in the below graph, relative to OECD countries, South Africa is substantially more reliant on corporate income tax, marginally more reliant on personal income tax, and less reliant on VAT, for its revenue.



33. Of all the countries studied by the OECD as part of its Revenue Statistics research, South Africa places one of the highest tax burdens on companies at 4.2% of GDP (based on 2016 OECD data). This is also higher than all of South Africa's main trading partners.

34. The result is that South Africa has become overly reliant on corporate income tax (with our companies suffering a high CIT burden compared with other countries) while the tax burden on individuals has returned to (and has now exceeded) the levels it was at in the early 2000's. This results in a number of disadvantages:

- Tax revenues are now more highly exposed to volatile corporate profits, as was illustrated in the wake of the 2008 global financial crisis and, more recently, the current fiscal year (i.e. 2019/20). In the wake of the 2008 financial crisis, corporate tax revenues dropped to less than 5% of GDP. Corporate tax revenues are now forecast to fall further to 4.2% of GDP this year.

- Corporate taxes have been shown to have the greatest distortionary effect on economic growth. A high corporate tax burden therefore translates to lower economic growth. The high tax burden on South African companies means that our corporate tax system is relatively uncompetitive compared to those of our main trading partners and countries with whom we compete for investment.

- Personal income taxes are collected from a very small pool of taxpayers with the overall tax burden now projected to reach record levels. This tax burden is relatively high by global standards, exceeding the average for OECD countries and well above other developing countries. In addition, the highly progressive nature of personal income taxes means that the bulk of this burden is borne by a small portion of the tax base. It is estimated that just 25% of those who pay income tax pay 80% of all personal income tax that is collected. Over the past few years, a smaller proportion of taxpayers has become responsible for an increasingly large portion of total personal income tax payable.

- High income taxes result in lower levels of consumption and savings. These in turn translate into lower economic growth. According to studies conducted by the OECD and others, personal income taxes are, after corporate income taxes, the next most damaging tax for economic growth.

- By contrast, consumption taxes, because they do not distort savings and investment, have been shown to be less damaging for economic growth. Recurring taxes on immovable property (for example municipal property rates) have been shown to be the taxes that are most conducive to economic growth as they have a limited effect on the demand and supply of land.

35. Research conducted by the OECD and other bodies suggests that growth-friendly tax reform would shift the tax burden from taxes on income (corporate tax in particular) to consumption taxes, such as VAT, and recurring property taxes. Of course, this means that there is a trade-off between the economic efficiency of the tax system and equity or the progressivity thereof. However, it is important to bear in mind that no single tax instrument should be considered in isolation in measuring the progressivity of fiscal policy. The totality of fiscal policy, comprising tax policy and spending, should be considered holistically when measuring the redistributive effect thereof. After all, most of the reductions in inequality through fiscal policy are achieved through spending and not through taxation instruments.

36. South Africa's tax mix is skewed towards a greater reliance on direct taxes and less of a reliance on indirect taxes. While this results in the tax system being relatively more progressive, it comes at the expense of a tax system that is not as growth-friendly as it could be.

SACU

37. In terms of the SACU agreement, a combined revenue pool is created for purposes of sharing customs and excise duties, while trade between the SACU member countries is duty-free. The combined revenue is shared between the member countries in terms of three formulae:

- Customs duties are shared based on relative intra-SACU imports;

- Excise duties are shared based on relative GDPs; and

- A development component derived from excise duties is shared based on relative GDP per capita.

38. Unfortunately, the revenue sharing formulae are weighted heavily against South Africa and in favour of the other member countries. Of particular concern is the formula for

sharing of customs duties. South Africa has significant trade surpluses with all of the other member countries. The result of these significant trade surpluses is that the bulk of customs duties in the combined revenue pool accrue to the other member countries, notwithstanding that the vast majority of customs duties collected relate to goods that are consumed in South Africa. To illustrate the point, the total value of imports by South Africa in 2014 amounted to R1.083 trillion. South Africa's SACU exports amount to approximately 83% of all intra-SACU trade. The result is that South Africa's share of the SACU customs pool amounted to only 17% for 2013/14.

39. To put the above into perspective, a more equitable sharing of the customs revenue pool would see South Africa entitled to at least 80% (and possibly as much as 90%) of the pool. For the 2020/21 fiscal year, the cost to South Africa is based on forecast SACU payments to be made by South Africa of approximately R63 billion. This equates to a staggering 1.2% of South Africa's GDP, a cost that is unsustainable and that far exceeds the benefit for South Africa of being able to export goods to SACU members on a duty-free basis.

40. The BLNE countries have become heavily dependent on the SACU revenues to fund their fiscuses. The result is that South African taxpayers are subsidising SACU member countries to a significant extent and this puts a large strain on South Africa's fiscal position.

41. Given the fiscal crisis in which South Africa finds itself, it is difficult to justify South Africa's continued subsidisation of the BLNE countries to the extent that is currently taking place. While the fiscal stability of these countries must obviously be taken into consideration in order not to destabilise the region, it is now more urgent than ever that the agreement be renegotiated in order to provide for a more equitable sharing of revenues.

42. This issue was raised in our submission to this Committee on the 2017 and 2019 Budgets. Since then, no mention has been made in any of the annual Budgets of any progress with any negotiations on new revenue-sharing formulae, and it seems that little progress has been made in this regard. Our understanding is that the BLNE countries are reluctant to renegotiate the revenue-sharing formulae, for obvious reasons. This is not surprising - it is akin to asking turkeys being asked to vote for Christmas. It is, however, crucial (given the dire fiscal position of South Africa) that the formulae are renegotiated as a matter of urgency.

B. Revenue proposals

43. We set out below our comments on the revenue proposals.

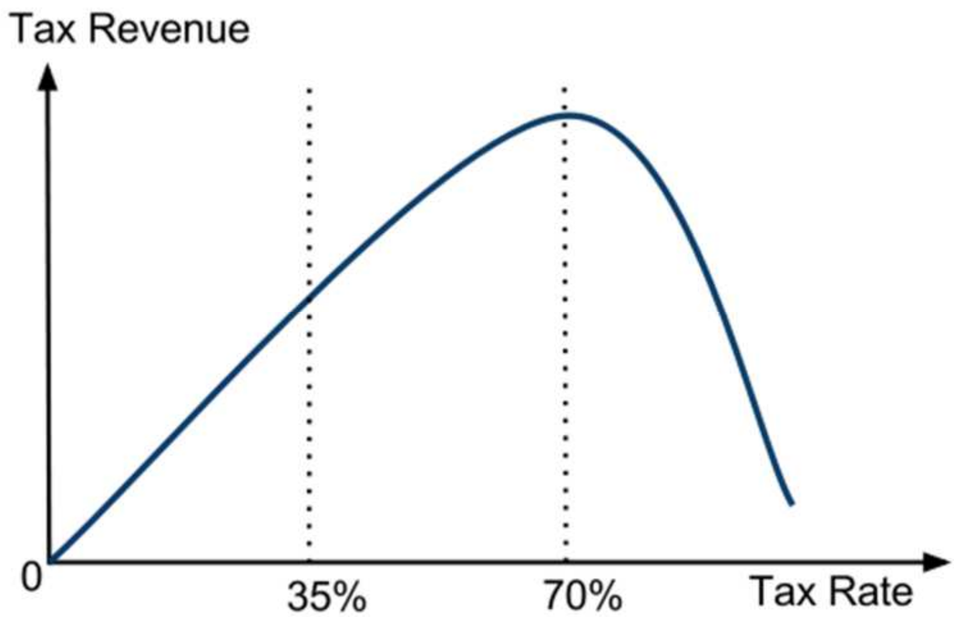
Tax increases and tax structure

General

44. Generally, we welcome the proposal that there be no tax increases for 2020/21, and that government will not raise any taxes to collect an additional R10 billion as per its announcement to this effect in the 2019 Budget. In our view, this proposal should be strongly supported on the basis that, as acknowledged in the Budget Review, tax increases at this point will most likely serve as an obstruction to economic recovery and growth.

45. It is, moreover, clear that tax increases in the past few years (in the form of both personal income tax increases – mainly by failing to make inflationary adjustments to the personal income tax brackets, and VAT – by way of the increase in the VAT rate from 14% to 15%) have not translated into significant additional revenues. This is because these tax increases have had a pronounced negative effect on economic growth, thereby placing extra downward pressures on tax revenues, and on levels of tax compliance (i.e. tax increases were effectively "self-defeating").

46. The proposal not to raise tax rates recognises the principle that, once levels of taxation reach a certain point, rather than increasing tax revenues, they actually result in a reduction in tax revenues as the disincentive elements outweigh the higher tax rates. This is graphically depicted by the Laffer curve, which may be represented as follows:



47. While no study has been made of the Laffer curve in the South African context, all indications are that tax increases over the past few years resulted in tax revenues having gone over onto the downward slope of the Laffer curve.

Personal Income Tax

48. For the reasons set out under our general comments relating to tax increase and tax structure above, we welcome the relief provided to individuals by way of an above-inflation adjustment to the personal income tax brackets.

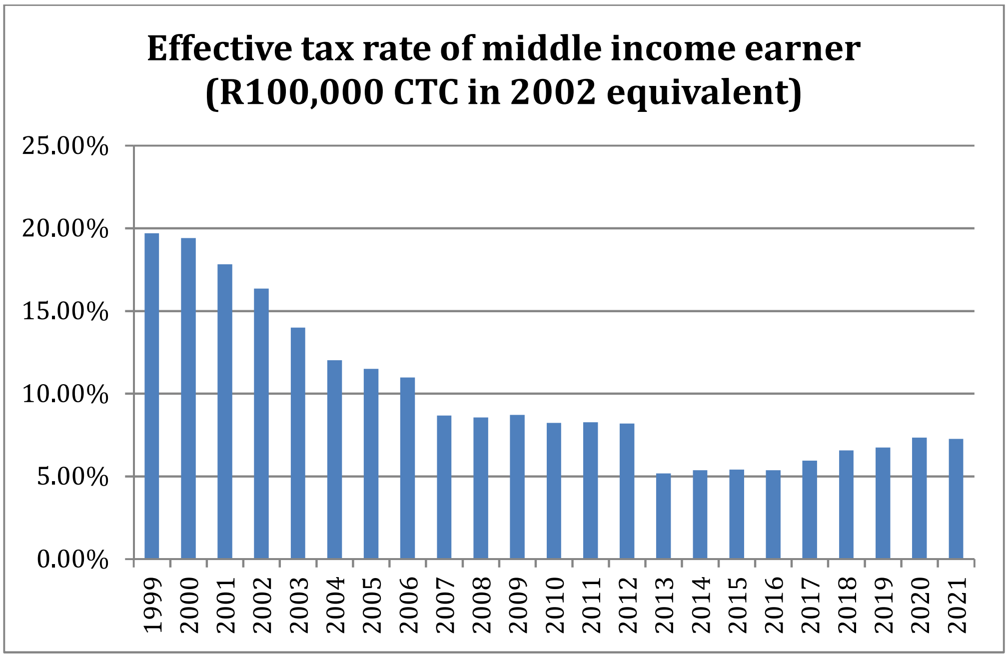
49. It is abundantly clear that increases in PIT rates in recent years have not translated into increased revenues. This is easily supported by the fact that the estimated PIT to GDP ratio 2019/20 only increased to 10.2% (from 10% in 2018/19), despite the significant effective increase in the PIT rate in the 2019 Budget as a result of the lack of any inflationary adjustment to the personal income tax brackets in that year. In the 2019 Budget, tax increases in PIT of R13.8 billion were announced. It is, however, now forecast that the shortfall in PIT collections will amount to R25.3 billion.

50. The relief provided in respect of PIT in this year's Budget will, by facilitating increased consumption and savings, have a direct stimulatory effect on economic growth, which is vital in order to increase overall tax revenues.

51. The above having been stated, we believe that it would be appropriate – in order to further elaborate on the positive effects of the PIT relief afforded to individuals – to make the following general observations regarding PIT:

    - It is widely accepted that direct taxes (such as PIT and corporate income tax (CIT)) are more "distortive" than indirect taxes (such as VAT) on consumption. This means, essentially, that direct taxes reduce economic activity to a greater extent than indirect taxes, and therefore have more of a negative effect on economic growth than indirect taxes. Conversely, a decrease in direct taxes will have more of a positive effect on economic growth than a decrease in indirect taxes.
    - It is also widely accepted that direct taxes serve as a disincentive to save and invest. Consequently, relief from direct tax (such as a reduction in personal income taxes) could result in an improvement in South Africa's poor levels of household savings.
    - High taxes also act as an incentive for taxpayers to avoid or evade the taxes. It is apparent, from SARS's tax statistics, that there has been a marked decrease in the levels of compliance in recent years. The proposed PIT relief should therefore assist in reducing the incentive to avoid and/or evade taxes by improving taxpayer morale and trust in government.

52. The effect of the PIT relief is illustrated in the below graph, which shows the effect of adjustments (or lack thereof) to the PIT brackets since 1999, for a middle-income earner (with annual taxable income for 2020/21 of approximately R274 000)[2].



53. As is evident from the graph, the average tax rate applicable to middle income earners has been gradually increasing since 2013/14, with a marked acceleration since 2016/17, and finally a slight decrease in 2020/21[3].

Business

Company tax rates

54. In our comments to these Committees on the 2019 Budget, we welcomed the decision not to increase tax rates on companies. We noted that South Africa's corporate income tax rate is relatively high by global standards and the CIT burden is amongst the highest in the world. We further drew attention to the fact that any increase in the tax rate would negatively impact the country's competitiveness and increase its susceptibility to base

[2] Although the graph shows only the effect of adjustments to PIT brackets for on the effective tax rate of middle income earners, the relief has been provided across all income brackets, with the result that graphs depicting the effects for low- and high-income earners will be broadly in line with this graph.

[3] Although the average tax rate is significantly lower than the average tax rates in the early 2000's, it must be noted that the graph oversimplifies the changes in tax burden over time because it does not take into account significant base-broadening reforms that also took place in the 2000's (such as the introduction of capital gains tax and the reform of the taxation of fringe benefits, including travel allowances, share-based remuneration, company cars, and entertainment allowances). The result is that the actual effective tax rate in the early 2000's would be significantly lower than that indicated where the same remuneration package had been structured tax efficiently.

erosion and profit-shifting and noted that the global trend in corporate income tax rates is downward.

55. We note that this year's Budget affirms the above principles and proposes a restructuring of the corporate income tax system over the medium term by broadening the base and reducing the CIT rate.

56. We are generally supportive of the adoption of policies aimed at broadening the CIT base with a view to reducing the CIT rate. Moreover, such an approach has been accepted as being supportive in the facilitation of inclusive economic growth. In this regard, the following statement, which we support, regarding the maintenance of broad tax bases and low tax rates is made in a 2016 OECD working paper[4]:

> "*A tax system is considered efficient if, for any given amount of revenue to be raised, it distorts behaviour as little as possible. A base-broadening and rate-cutting reform should reduce distortions by reducing overall tax rates and removing incentives for taxpayers to change their behaviour to take advantage of tax reliefs. In considering the economic efficiency case for removing tax reliefs and broadening the tax base the underlying need for revenue neutral reform is crucial. When tax reliefs are given, tax rates have to be higher than otherwise.... There is thus a strong presumption (aside from cases where reliefs play a role in correcting externalities) that reforms that enable a reduction in tax rates will increase economic efficiency.*
>
> *Moreover, broad bases simplify the tax system by reducing exemptions, allowances, credits and/or rates differentiation. This simplification may reduce compliance costs related to individuals and businesses in terms of tracking tax-preferred activities, understanding qualifying and reporting requirements, time required to complete tax returns and to get the relief. At the same time, a broad base approach may reduce the administrative costs of defining the rules of preferential tax treatments, ensuring compliance with the rules (in terms of length of tax instructions and auditing time) or refund costs. Broader tax bases may also be more effective in terms of achieving higher levels of taxpayer compliance and reducing opportunities for tax avoidance, in turn enabling lower tax rates (for given revenue needs) and improving horizontal equity. Tax bases could be broadened in particular by removing tax expenditures that are not well-targeted at redistributive goals.*"

57. The above having been stated, we do wish to note the following concerns:

- Changes to the CIT rate will have a significant effect on investment decisions by prospective investors. It would therefore, in order to instil further confidence, have been preferable for the Budget to provide specific timelines and other guidance as to

[4] Brys, B. et al. (2016), "Tax Design for Inclusive Economic Growth", OECD Taxation Working Papers, No. 26, OECD Publishing, Paris. http://dx.doi.org/10.1787/5jlv74ggk0g7-en; at pages 50 to 51.

how and when the CIT rate will be reduced. This has been the approach that has been adopted in other jurisdictions that have reduced their CIT rates, notably in the United Kingdom, which announced its reductions in the CIT rate well in advance, providing specific details as to the quantum of reductions and the timing thereof. This should have been possible given the relative certainty relating to the proposals for excessive interest deductions and limiting the use of assessed losses which are due to take effect in 2021.

- Regarding the review of tax incentives, we are supportive of the overall, broad principle that it is preferable to have a lower CIT rate across a broad base than a higher rate across a narrow base with a large number of incentives. However, in the context of the complexities of commerce and industry, no principle should be blindly adopted as being absolute. Efficiency, flexibility and effectiveness dictate that there must always be exceptions to overall broad principles. There will always be a place in a sophisticated tax system for well-designed, appropriate and effective incentives.

- Regarding the proposed limitations on use of assessed losses, it is acknowledged that, to an extent, South Africa's treatment of assessed losses is generally relatively generous towards taxpayers as compared with their treatment in other jurisdictions, and that there is a global trend towards limiting the use of assessed losses. However, as is the case with all changes to existing rules that have a wide application across different types of taxpayers, the devil will be in the detail. One example of where difficulties could arise is the treatment of assessed losses in the context of entities that are entitled to accelerated capital allowances, such as section 12C of the Income Tax Act. Where a taxpayer is, as a result, entitled to a preferential deduction in year 1 and that deduction results in the taxpayer being in an assessed loss in year 2, the limitation of the assessed loss of the taxpayer in the manner proposed in the Budget could result in the benefit of the section 12C allowance being undermined. Caution would therefore need to be exercised to ensure that the limitations on use of assessed losses does not result in unintended consequences.

- Regarding limitations on interest deductions, we note the release, by National Treasury together with the publication of the Budget documents, of a discussion paper titled "*Reviewing the tax treatment of excessive debt financing, interest deductions and other financial payments*". This paper has been released for public comment, and comments thereon are due for submission on 17 April 2020. While we appreciate National Treasury's consultative approach and look forward to considering the paper and engaging with National Treasury thereon, we note that the document is extremely detailed and comprehensive and the matters it raises have considerable import in the context of all industries and for a significantly large proportion of all taxpayers. We understand that National Treasury has been engaged in its preparation for over two years. We are therefore concerned that the period afforded (approximately only seven weeks) to both consider and provide comments thereon is woefully inadequate. Once again, the devil is in the detail and caution will need to be exercised so as not to result in unintended consequences.

We thank you for the opportunity to offer our opinion on the Budget fiscal framework and revenue proposals, and we trust that you find this to be of assistance in your deliberations. Please do not hesitate to call on us for further analysis.

Yours sincerely,

Kyle Mandy
Tax Policy Leader
kyle.mandy@pwc.com
+27 (11) 797 49 77

Greg Smith
Senior Manager: Tax Policy
greg.smith@pwc.com
+27 (11) 797 4588